RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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July 8, 1992 **LETTER 1099**

ECONOMY: Whoops! Unemployment up to 7.8% in June (an eight-year high). Employment down by over 100,000 (that was a shock). Tool orders down 28% in May, durable goods down 2.5%, housing sales down 5.6% in May for their fourth decline in a row (sales declined 34.4% in the West, the sharpest drop on record), home prices down, car sales sputtering (GM's total 1992 sales are up only 1.7% from disastrous 1991 levels), Purchasing Agents' Index dropping back to 52.8%.

This is a recovery? The secret that Washington won't admit -- without rising home and car sales, there can't be a recovery.

On July 2 (reacting to the awful employment and unemployment news) the Fed panicked and dropped the discount rate a full half percent to 3%. With this latest act, the markets have to believe that the Fed has "shot its wad." There's nothing left on the downside, unless the Fed drives up with a dump-truck and gives money away.

STOCK MARKET: Ah, they never make it easy for you on Wall Street. The market rallied strongly from June 29 through July 1. Question: Is this it? Is this the true, bonafide, honest-to-gosh, revival of the long-sleeping bull market? Or is it the last hurrah, the final summer rally (remember 1972), the rally that rekindles optimism and brings the hopeful in for that last doomed surge prior to the top?

Let's face it, you pessimists, there's been no Dow Theory bear signal (the Dow never broke down). And my Primary Trend Index (PTI) never turned bearish. Furthermore, there's been a big surge in investor advisory pessimism (could it be totally misplaced?). Last but not least, our hero of the past two years, the Fed, continues to fight the "nothing economy" tooth and nail -- yep, fighting it with 24 assorted declines in the Fed Funds, the discount rate or the bank reserves.

THE BIG PICTURE: Obviously, I can't prove it, but I've been wondering if maybe we're seeing the beginning of a global bear market. Here are a few statistics that bother me: Australia's stock market is down 29% from its record high; France is down 6.8%; Germany down 9.6%; Italy down 48%; Japan down 60%; Spain down 24%; Sweden down 30%; UK down 4.4%; USA down only 3.6%. Finally, the *Economist's* World Index is down 12.3%.

Question: How is it that the US stock market has been doing so much better than the rest of the world's markets? Answer (or at least my theory): We start with the fact that the dollar's been collapsing. Consciously or unconsciously, US investors are saying, "I'd rather be in stocks than in dollars. At least stocks represent something of value; stocks represent actual equity in a real, live corporation. With the US running deficits of half a trillion dollars a year and George Bush shouting for even lower rates, I'm afraid of dollars. Frankly, if I'm going to lose money, I'd rather lose it in stocks."

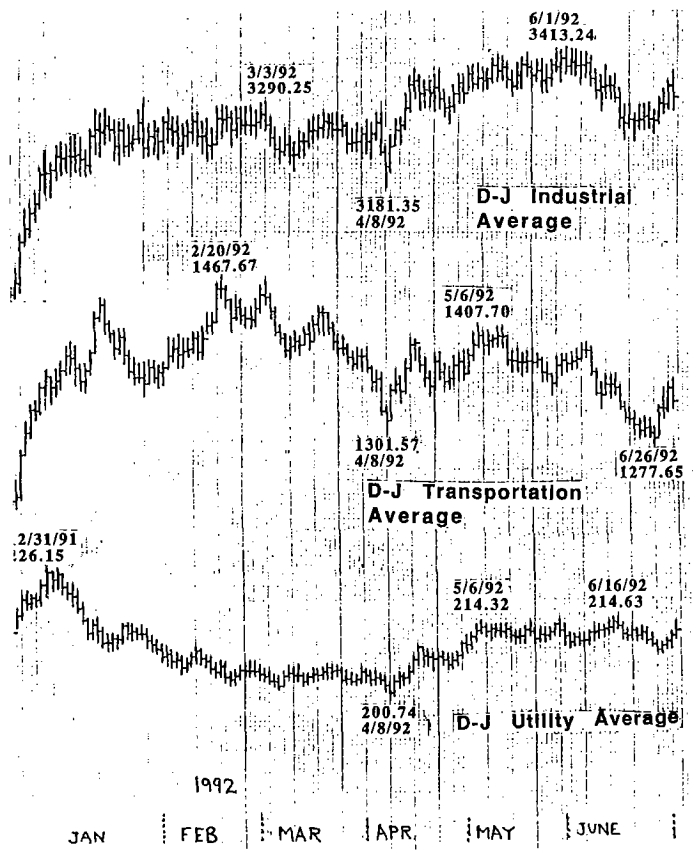
Question: So who wants dollars? Answer: At present, only Americans, who are unfamiliar with trading or holding foreign currencies. Study these three-month Euro-currency rates: British sterling -- 10%; Dutch guilders -- 9 3/4%; Swiss franc -- 9 3/4%; D-mark -- 9 1/4%; French franc -- 10 1/8%; Danish krone -- 11%; Spanish peseta -- 12 3/4%. And the three-month return on the dollar -- around 3.5%. So if you like money, if you like a return on your investment, why would you, as a knowledgeable international investor, want to be in dollars?

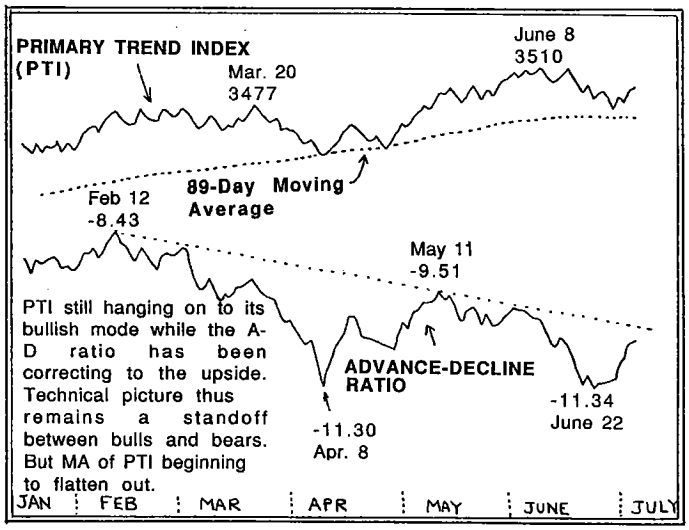
June 26 DJIA 3282.44; PTI 3484; A-D Ratio -11.18
July 2 DJIA 3330.32; PTI 3500; A-D Ratio -10.42
Dow Yield: 3.10%; Dow Price/Earnings: 69.2
Dow 200-day MA: 3182; Dow 30-day MA: 3336
Dow Times Book Value: 2.50; PTI 89-day MA: 3476
Percentage of Undervalued Blue-chips: 10%

Let's face it, the US economy is still nowhere. The US continues to run huge deficits, but despite those deficits the US still can't really get out of recession. In a frenzy to re-inflate the economy, the Fed has ballooned bank reserves and driven down short-term interest rates to 20-year lows. But in doing so, the US has, among other things, sacrificed its currency.

Question: Where are the losses? Answer: The losses show up in two areas. The losses show up in the majority of stocks on all the US stock exchanges (for proof, check the chart of the advance-decline ratio on page 2). If you're a German or a Frenchman or a Swissman, you know well enough where the losses are. The losses are in anything denominated in dollars -- from houses to salaries to property to US stocks and bonds. Let me put it this way -- from an international standpoint, if it's expressed in dollars, it's probably worth less than it was a year ago.

Question: How long can all this go on before it finally sinks in to the consciousness of Americans? Say you're a foreign investor or a foreign bank or insurance company, and you own a slew of US securities. How long can you take these dollar losses without panicking? How long can you sit, white-knuckled, as you watch the dollar and your investments go down the drain?





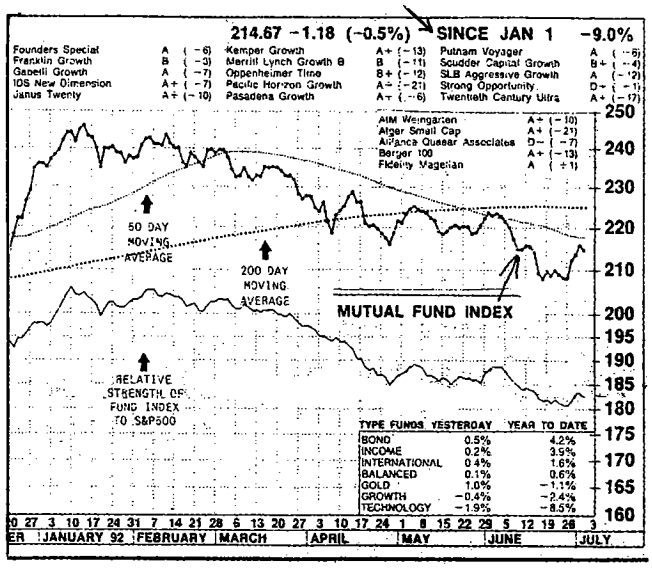
Russell answer: Darned if I know how long the world can sit by and watch its reserve currency, the dollar, sink (of course, there are always sporadic rallies). But it will sure be interesting to find out.

Question: US investors have been pouring their money into mutual funds -- so what about those funds? Answer: The mutual fund picture looks a bit on the grim side. Again, I include the Mutual Fund Index (page 2, courtesy of *Investor's Business Daily*). Here we see the losses in 20 of the leading mutual funds at 8.5% so far in 1992. Furthermore, note on the relative strength line that these 20 leading mutual funds have not only lost 8.5% of their value since January 1, they have performed considerably worse than the S&P 500. Since last December the public has been buying mutual funds in record amounts. At this point they can hardly be happy with the results of their investing.

Russell observations: I don't like this kind of slow erosion we've been seeing in the market. I don't care for a market that is continually "bulled" by the Fed. I don't like the fact that the public has remained basically optimistic (or at least hopeful) about the market. I don't like the way the Dow holds up (keeping everyone hoping) while the majority of stocks have continued to erode. I don't like the way the Transports remain weak, even on those days when the Dow rallies. I don't like the way the "big name-analysts" (check the *Forbes* and *Barron's* columnists) keep recommending stocks to buy, while completely ignoring the poor market action. I don't like the way the dollar continues to unravel. I don't like the way the leading mutual funds have faded. And I sure didn't like the crash-action in the big Tokyo market.

Often the commodity speculators are more "with it" than the people who invest in the stock market. They have to be, because trading in commodities is faster and tougher (and infinitely harder on your nervous system). Along those lines, here's an interesting quote from the current issue of *Commodities Information Systems* [(800) 231-0477]: "The early '90s will go down as one of the most unstable economic and political periods in modern history. Eastern Europe was freed and is now overcome with ethnic strife and chaos . . . the Soviet Union collapsed and is now falling deeper into economic depression . . . racial strife has left the once strong S. African economy in shambles . . . collapse of the Japanese stock market has crippled world liquidity . . . rejection of the monetary union has set back hopes for an united Europe . . . for the first time, the US has a 'lame duck' congress coming into the presidential election . . . and election year politics are in disarray with the third party candidate, Ross Perot, leading current polls. *The most remarkable aspect of this period is the fact that so few people recognize the enormous uncertainty that lies ahead."* Russell comment: I agree. The complacency today is really breath-taking. The public's attitude: "What me worry? Listen, if there's anything wrong, the government will come in and fix it."

Here's something that Joe Granville and I learned the hard way (by the way, Joe and I have been reading each other's reports for over



thirty years). *The indicators don't work the same during bear markets as they do during bull markets. The reason is that when the primary trend turns down, the pessimists, the bears, are correct. In a primary bear market the bears are on the right side of the market.*

Thus a high short interest does not work in a primary bear market the way it works in a primary bull market. High odd-lot shorts mean a good deal less in a bear market. Unlike action in a bull market, low volume as the market declines is not a good sign in a bear market (it simply means that fewer people are getting out). Downside non-confirmations mean less in a bear market, since in due time most stocks follow the lead of the average that breaks down (in other words, in a bear market the penetration of one average below a given level is usually confirmed in time by the other averages). Finally, in a primary bear market the oversold areas are usually massive, whereas the overbought areas tend to be mild.

If this is the early beginning of a primary bear market then it is normal for the market to have many confusing fits and starts. This is because there is a lot of switching going on plus a lot of careful and subtle distribution. Large interests with tens of millions of dollars of stocks to dispose of desire one thing more than anything else -- that one thing is good news. Good news brings in the public, and it makes stocks infinitely easier to dispose of.

Veteran market practitioners know that there's nothing more bearish than a market that is eroding in the face of good news. By the same token, veterans know that there's nothing more bullish than a market that is pushing up in the face of bad news.

Here's another important phenomenon to watch. In a primary bear market (remember, we're still waiting to see whether we're in one), you seldom get what I call "a good up-day." What constitutes a good up-day? A good up-day occurs when literally everything goes up -- the Dow, the Transports, Utilities, the broad composite averages, highs over lows, advances over declines, bonds, volume. In a bull market you will get those kinds of days, a lot of them.

But in a primary bear market there's always "something wrong." And that wrong action (on rallying days) is the kind of action we're seeing now. The Dow goes up but the Transports are down. The two Averages rally (Transports weakly) but the bonds are down. The Dow is up but breadth is down. Breadth is up, but there are more new lows than new highs. That's life in a bear market.

UP-DATE: On June 22 the D-J Transportation Average broke below its critical April 8 level of 1301.57, thereby rendering half a Dow Theory bear signal. But as every Dow Theorist knows, half a bear signal is no better than none. If you follow the Dow Theory you know that confirmation by "the other Average" is absolutely critical.

happened to the Roman Empire, and others before and in between, and it is happening to America today.

"It has not occurred totally; there is a long way to go. But the course is set, and a crucial confirmation is that the United States is no longer the world's richest country, but instead is the world's greatest debtor."

NOTES & QUOTES: Ross Perot are you listening? Sure I have doubts about Perot, but the single most important item on the Perot agenda from this point on is picking a vice president. Who Perot picks will weigh heavily on his chances for the presidency. There's no question in my mind but that the absolute best choice for vice president would be former Fed chairman Paul Volcker. Volcker ("Mr. Sound Dollar") would give the Perot ticket a credibility and legitimacy that would satisfy (actually electrify) Perot's major enemies -- Wall Street, the establishment, and big business. A Perot-Volcker ticket would tell the world that Perot was not a wild-eyed kook, not a little dictator, and a man who was not afraid of a powerful, influential running mate. And think of the contrast of 6' 6" cigar-smoking Paul Volcker and 5' 6" flap-eared Ross Perot. Sure they'd call them Mutt and Jeff. But it would be one heck of a ticket. Question: The election is four months away, can this country take four more months of the kind of political shenanigans we've been seeing?

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10 percent of all Japanese securities are owned by the Japanese banks. The banks can count paper profits in securities as part of their reserves. In 1991 the paper profits of Japanese banks were $170 billion. As of last week (with the Nikkei down 60% from its high), the paper profits had dropped to $57 billion. The Japanese banks are now in a squeeze, and loans are being curtailed. And the talk is of Japanese Gross Domestic Product going flat or even negative.

Furthermore, many (some say most) of the properties the Japanese bought in the US for top dollar are now in trouble. The Japanese are trying to sell these properties off, or, if they keep them, they will need new infusions of cash. Where's the cash to come from? According to the *NY Times* (June 22) the Japanese have liquidated over $8 billion in muncipal bonds.

The June 22 *LA Times* front-pages an article stating that Japanese women usually handle the family finances, and that many wives have (unknown to their husbands) invested in the Tokyo stock market. Now the wives are faced with telling their husbands about disastrous losses. Wrote the *Times* of one wife -- "Now he's threatening divorce. Creditors are circling. She is overwhelmed with shame. She has lost hearing in one ear and her hair is falling out. 'I have thought a lot about suicide,' Arai said. 'But even if I do it, the life insurance won't cover my debts.'"

Meanwhile, *Crain's New York Business* in an article headlined, "Japan Says Sayonara to NYC For Now," states that "by one estimate 10,000 of the 50,000 Japanese executives in New York City have been repatriated . . . It's but one example of Japan's about-face from New York. After pumping billions into the local economy, Japan's plunging real estate and stock values have prompted a retreat from the city."

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Bush, who on July 2 got his way with the Fed, finally figured out that the economy is not doing that well. *Sindlinger* currently counts "10 states in depression" with eight states in "borderline depression." The 10 depression states in descending order are Maryland, Illinois, Delaware, W. Virginia, Pennsylvania, New Jersey, Connecticut, New York, Michigan and the worst -- California. As for California, what with the riots and the earthquakes, it's probable that fewer people will be moving here. Ah, that would be a blessing.

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"B-Day" was July 1. That's the day when an (estimated) $15 Billion worth of municipal Bonds were called for redemption, making July 1 the biggest bond redemption day in history. Those reinvesting will be facing yields of anywhere from 40% to 75% below their previous yields. In the early '80s, when many of these munis were purchased, yields were around 12%.

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In a recent poll, 42% of Germans believed their nation could get along without any military whatsoever, while 11% were undecided. With Russia no longer the enemy, it is reported that German soldiers no longer know what their duty is. Russell comment: As I've said so many times, the coming world battle will be economic, not military. The US no longer has any major enemy, and with our current monster deficits there will be increasing pressure to downsize the military. The main reasons for massive military spending now are (1) job creation and (2) research -- a major portion of US research is an off-shoot of military spending. But number one is ridiculous, and number two is inefficient.

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Africa: AIDS transmitted via heterosexual contact is sweeping Africa where polygamy and prostitution are endemic. Dr. Roy Anderson (head of the Imperial College of Science and Technology, London) in a new study states that the picture is far gloomier than that which has been put forth by the World Health Organization. Anderson says that in a matter of years Africa's population growth rate (decimated by AIDS) will turn negative. The conservative estimate by WHO is that six million Africans are now infected by the HIV virus and that by 1995 the figure will rise to 10 million. In Uganda, one-tenth of the population is now infected with the HIV virus.

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Financial World did a study of what the 102 major league sports clubs are worth. The top five most valuable were all in major league baseball. These include the NY Yankees (worth $200 million), LA Dodgers ($180 million), NY Mets ($170 mils.), Toronto Blue Jays ($160 mils.), Boston Red Sox ($160 mils.). In football, the most valuable are Miami Dolphins ($150 mils.), NY Giants ($150 mils.), Dallas Cowboys ($146 mils). In basketball, LA Lakers ($150 mils.), Detroit Pistons ($120 mils.), Boston Celtics ($110 mils.). Russell question: I'll be interested to see what these franchises are worth (1) if football players get free agency, and (2) if the money from new TV contracts is substantially reduced, which is a good possibility.

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My old buddy, Aaron Russo, came down from LA to visit me last week (Aaron is a movie producer, -- did Midler's "The Rose" and Murphy's "Trading Places"). Eighteen months ago Aaron moved with his family to the island of Moorea, nine miles off the coast of Tahiti. He says it's the closest thing to paradise. Great weather, little or no crime (murder is practically unknown), gorgeous warm, clear ocean water, fresh fish at a dollar a pound, fruit and veggies galore, and peace and quiet. Aaron gets all the market closing figures by FAX daily. He's a student of markets and social trends, and he's pessimistic about the US and its stocks (bullish on gold). Thinks the dollar is headed for extinction. With it all, Russo may drop anchor in LA for a while. He's got some movies he wants to make (yep, I think he's got the movie-making bug again).

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Got a FAX from Sir Harry Schultz. Help, he wants us to meet him in Europe, but he knows how I hate to travel. Wish I knew more about Enkankar, the ancient, mystical method of traveling via mind waves. Now if I could only get to Europe via something besides slow boats and cramped planes.

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The eleven man NBA Olympic squad was practicing here at UCSD in La Jolla. I've seen a few seven foot guys walking around La Jolla, but not being a basketball maven, I can't tell which is which. But these guys are BIG, very BIG.

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Forbes writes about Robert George, who runs Lloyd George Management Ltd., a $150 million fund for institutional money. George is convinced that China is the coming industrial power of Asia. Is he worried about the takeover of Hong Kong by the communists in 1997? Evidently not. George is looking for small companies run by overseas Chinese families. "What we do is to follow the trail of the private entrepreneur, the small Chinese businessman who knows his way around China." George says that Chinese businessmen from outside China have, so far, invested $20 billion in China.

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On June 22 the advance-decline ratio broke below its April 8 low, thereby wiping out all upside action in this index for the year. When the A-D ratio breaks down, it's usually "an unhappy proposition" for those holding common stocks. That statement is backed up by the action of the Mutual Fund Index.

KEYS: As far as I'm concerned, there are now two keys to the picture. They are: (1) the action of the Dow, and (2) the action of the Primary Trend Index (PTI).

From a Dow Theory standpoint, either the recent Transport penetration of its April 8 low will be confirmed by the Dow or it won't. As matters now stand, we have an important downside non-confirmation in that the Dow refused to confirm the breakdown in the Transportation Average. The fact is that the Dow has been incredibly resistant to decline. The non-confirmation by the Dow set up the market for a rally. So let's see what kind of a rally we get.

It is critical for the bull case that the Dow continue to hold above its April 8 low of **3181.35.** Remember, if the Dow breaks below its April 8 low of 3181.35, then a primary bear market will be signalled. Obviously, that has not happened. In fact, the Dow never got within 100 points of the critical 3181.35 level. So far, so good.

Perhaps, coincidentally, the 200-day moving average of the Dow is at 3182, almost at the same level as the April 8 low for the Dow. Thus, I take the 3181.35 level as being doubly important.

PTI: My PTI, like the Dow, has been very resistant to decline. But in this business you have to be prepared for any contingency. So once again -- here's the "fail-safe" picture. The PTI remains bullish. But if the PTI should break decisively below its 89-day moving average and continue down, I will say that a bear market is in force. As in the case of the Dow, that has not yet happened. In fact, as it has done so often since its late-1991 bull signal, the PTI approached its moving average, then rallied. Pretty impressive, at least so far.

INVESTMENT POSITION: The bull is still in the box, courtesy of the extraordinarily resistant Dow and the equally resistant PTI.

Nevertheless, this has been a very difficult market to be in, and darn few people have held their own in it. The obvious (and easiest) best place to be this year has been in the strongest Dow Industrial stocks, stocks like GM, IBM, Goodyear, etc. The worst place to be was in any diversified portfolio, since the great majority of diversified portfolios have lost money.

Picking winners in a market like this is always difficult and frustrating. The old adage states that bull markets make geniuses of us all. But there just haven't been very many geniuses here in '92. For every winner you picked, two other stocks were likely to have gone down.

I've felt that the most obvious trend over recent months has been the weakness in the dollar. The weak dollar trend has been persistent and backed by fundamentals. The fundamentals are clear -- the federal budget continues chronically negative as does the US trade balance. On top of that, Fed policy has been to attempt to stimulate the sluggish US economy prior to the election with low interest rates, and if the dollar falls apart, why, so be it.

Earlier I had advised moving into one of the stronger foreign currencies such as the German mark or the Swiss franc. More recently I have suggested buying a no-load foreign government bond fund and specifically the Benham European Government Bond Fund -- (800) 321-8321. With foreign bonds the thought is that yields are attractive, in the 9-10% range and in some nations (Spain, Italy) nearer the 12% range. I felt that the foreign bonds were interesting for three reasons: (1) Government bonds, particularly European, are safe from default. (2) European economies are slowing down, and the pressure will be on European central banks to lower rates. Declining rates would be bullish for high-quality European bonds. (3) Finally, the trend of a weak dollar (or rising European currencies) would be bullish for US investments in European government bonds.

So far things have worked out pretty well for the Benham European Bond Fund. It has had a nice move since I first recommended it. I still like the fund.

With the latest discount cut, I think (I'm guessing, of course) that the dollar may have "had it" on the downside, at least for a while. The dollar is very over-sold, the foreign currencies are very extended on the upside, and I think US interest rates (again I'm guessing) are about on their lows. So if you're a dollar bear, cool it for a while. And stay out of Europe and Japan, the dollar won't buy much there.

As for the Hong Kong stocks that I have recommended, they have been acting well. The winner so far has been Hang Seng Bank. The newspapers are beginning to carry stories about the opening of China to foreign investors. The "China Card" could be the wild card in the world economic picture. It's the story of 1.1 billion people moving into the world economy. That's roughly one-quarter of the world's population coming to life.

HAILEY'S VIEW: The full extent of what our successive Congresses and Presidents (with the tacit acceptance of the American people) have done to this nation is just beginning to sink in -- and I emphasize, just beginning.

A few weeks ago I received a letter from Arthur Hailey, (he lives the Bahamas), the famous author of many best-selling boo ("Overload," "The Money Changers," "Wheels," "Airport," "Hotel," etc.). Here are a few paragraphs from that letter: "Dear Richard, I continue to admire (and share) your philosophy and get up early when I know that one of your newsletters is due and coming in by FAX. Since you say you 'read everything' just thought you might be interested in some remarks of mine recently made in Japan -- five one hour lectures . . . Interest in the lectures was gratifyingly large, because I have millions of Japanese-translated books and accompanying readers (in Japan *everybody* reads books and people come up to you, wanting to discuss them in detail, sadly in contrast to the US and Canada where book sales, including paperbacks, are nowadays plummeting) . . . Smallest audience 900, largest 1,300, -- which would have been bigger except the organizers ran out of tickets and space."

At any rate, Arthur sent me a copy of one of his speeches. Hailey lived in California for years, and knows the US very well. In his speech to the Japanese he says, "I come and go to the US regularly, am comfortable there, and, certainly, in a mental sense, have a feeling of belonging -- obviously, because of friendships I have made and the books I have written about the American scene.

"I wanted to make that feeling, that caring, clear before telling you of another feeling I have right now about the United States -- and that is a tremendous feeling of sadness. Sadness as I watch, and emotionally share, the tragic decline and deterioration -- pragmatically and morally -- of that not-so-long-ago uniquely splendid country. The United States, despite the posturing of its politicians and their self-delusions, is no longer the world's leader and mentor, or even nowadays a super-power. Instead, American is on a long slide downward -- the same slippery slide that beset great powers and empires through human history.

"It is an age-old process that brings, first, enormous wealth and power, at first used wisely, but then as wealth and power corrupts (they always do!), there is a descent to lesser standards, excessive greed, complacency, a diminishing of resources and abilities. It

Speaking of investing, the US public has been buying no-load bond funds hand over fist. Total assets invested in CDs have dropped $102 billion this year, a drop of 10%. Money funds have dropped $7 billion. Where's the money going? A record-breaking $31 billion of it (this year alone) has gone into bond funds.

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Is one of America's richest men becoming less rich? Looks like it. The chart of Bill Gates' Microsoft (he owns $7 billion worth of it) has formed a massive top, and the stock is now breaking down. The newly-split stock broke below 70 last week, setting off a strong sell signal. I consider this action important, since Microsoft has been one of the darlings of the growth stocks in recent years.

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Final tally? Congressional Budget Office Director Reishayer told the Senate Banking Committee that of the 4,000 S&Ls that existed in the 1980s, roughly 1,400 will survive once the government completes its bailout. A few years ago the guess was that 2,000 would survive.

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The new "in" place for the younger set is Prague, Czechoslovakia. Prague is one of the few European capitals that was not damaged during either World War I or II. My daughter, Daria, visited Prague about five years ago, while it was still in Communist hands, and loved it then (despite the Commies). Now Prague is free and democratic. And the price is right. Rents run $50 a month, dinner is $2, and "the best beer in the world" is 30 cents a mug. Full time workers in Prague toil for around $100 a month. It is estimated that 10,000 Americans (mostly youngsters) have moved to Prague. The word: Prague is one of the world's most beautiful cities -- and the living is easy -- and cheap.

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To be a "Name" (i.e., a shareholder) in Lloyd's of London is very prestigious, and it's almost always been a money-maker -- until now. In 1989 Lloyd's sustained the greatest loss in its 304-year history, a loss of $3.83 billion. Since the Names are liable right up to their personal assets (each name must pledge a minimum of $400,000), the losses have hurt. Thousands of Names have resigned, few new Names have joined, and many Names have been forced to sell personal holdings such as homes to cover liabilities. In fact, sellers have actually knocked down the price of selected British real estate. Lloyd's blames much of their 1989 losses on the Valdez oil spill, Hurricane Hugo, and the San Francisco earthquake. Some Names (many are now facing financial ruin) are claiming mismanagement and even fraud at Lloyd's.

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Perot: The Bush people are mounting an all-out attack on Perot. Bush is known to be most effective when on the attack (Bush recently stated that he not going to worry about a guy who's wider from ear to ear than he is tall). In the meantime, *US News & World Report* did an excellent in depth piece on Perot. Perot keeps zeroing in on the deficit, which, of course, Bush has done absolutely nothing about. Says Perot: "Here's the saddest part of all -- the average guys have figured it out and nobody in Washington has. We're $4 trillion in debt, and we don't have anything to show for it . . . We've got the worst of all worlds now; a declining industrial base, declining schools and the most violent, crime-ridden country in the world. What did that $4 trillion buy?" Russell comment: I can answer that. The $4 trillion bought the same thing that 1992's $455 billion deficit bought -- it bought BIG GOVERNMENT. A shocking example: the budget for the House and Senate is $1.8 billion. C'mon, $1.8 billion to run the two houses. In case you've forgotten, a billion is a thousand million. Don't these guys in Washington have any shame?

If elected, Perot says he'll re-do the US tax system. The current system of using taxes to redistribute wealth or to spur certain segments of the economy is counter-productive and super-expensive. Only the flat tax makes sense. A flat tax of 17% with a value added tax of 7% would do the trick. It would also make life easier and saner for millions of tax-payers. Finally, it would eliminate the whole crazy tax industry, freeing tens of thousands of lawyers and accountants to do something useful. I firmly believe that the two biggest horrors in the US today are (1) the current tax system, and (2) the whole process of ever-expanding government entitlements, including the nutty, unfunded Social Security system. The first has crippled our industries, the second has crippled our economy. And both are getting progressively worse.

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Here's something I can't understand. California is broke, yet every days tens of thousands of Californians pour into Las Vegas and Reno to gamble and lose their money. And Nevada collects the millions in taxes. Why not set up a Las Vegas on the California desert, say 50 miles from LA? Why does the state of California (which is broke) sit on its fanny while its citizens donate millions in taxes to the state of Nevada? It doesn't make any sense. But don't tell the idiots in Sacramento that I said that -- it might set them to thinking.

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For years there were two forbidden areas, two areas that were never discussed publicly -- incest and homosexuality. Now both are out in the open along with child abuse, spousal abuse and anything and everything sexual. What are the forbidden subjects today? They are both economic. Nobody (certainly not the politicians) talks about the dangerous and explosive rise in entitlements. And nobody talks about the dangerous and explosive rise in the world population. Both of these, if current trends continue, will lead to disaster. Well, in all honesty, Perot is talking about Social Security, but his prescription (asking wealthy people to voluntarily forego it) is absurd.

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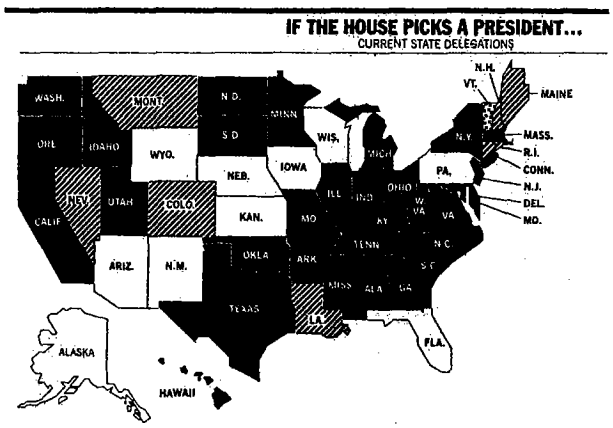
What if no candidate gets the 270 electoral votes necessary to gain the presidency, and the election goes to the House? Here's a look at the present make-up of the states with the black showing state delegations controlled by Dems. If these delegates vote their party, Clinton would be our new President. Of course each state having only a single vote for president is unbelievably undemocratic. I'm for a popular vote, with a president elected by the majority of Americans.



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Another potential Russell surprise: Perot (shocking) is elected to the presidency. Then (even more shocking) he gets absolutely nothing done because Congress fights him down the line on everything. Remember, Perot has no party behind him. Yeah, it could happen.

It was back in 1960 when I first met Harry Schultz. We immediately hit it off, and I spent a full day with Harry drinking beer and talking about the market. Harry was just about to start up his now famous *HSL International Letter*. Harry is probably the most traveled man in the world, having actually lived in, I don't know, 15 or 20 different countries. His reports are a mass of market facts, Schultz facts, and Schultz observations, instructions and philosophies. I wouldn't be without these letters, and I would guess that you might feel the same way. Harry tells me that if you write to **HSL, PO Box 622, 1001 Lausanne, Switzerland,** he will be happy to send you a free copy of his latest report. Do yourself a favor, take him up on his offer.

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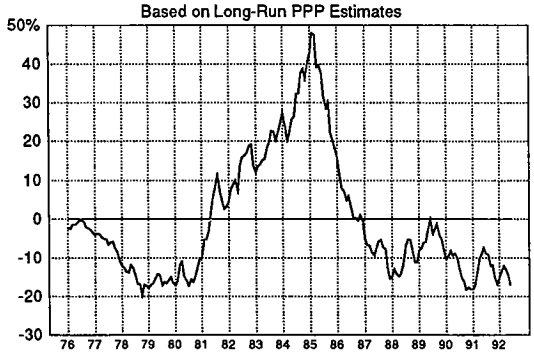
What's a dollar worth? Plenty if you live in the US and you're unemployed. But if you're touring around Europe or Japan the

greenback won't take you very far. Merrill Lynch in their excellent *Currency and Bond Market Trends* publication states that the Deutschemark is currently 16.4% overvalued vs. the dollar, the yen is 27.5% overvalued, the pound is 21.2% overvalued, while the Aussi dollar is 9.6% undervalued and the New Zealand dollar is 11.5% undervalued. This Merrill Lynch chart illustrates the broad under or overvaluation of the US Dollar Index. Right now, the Index is about 17% undervalued. Under "normal" conditions, that would call for a dollar rally. But with the US discount rate at 3%, is today normal?

U.S. Dollar Index: Percent Over/Under Valued
Based on Long-Run PPP Estimates



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My friend Jim Grant (as he has for years) is spreading the word about the debt situation and the sinking dollar. On July 6 Jim had editorials in both *Barron's* and the *WSJ* (quite a feat!). Grant's new book, *"Money of the Mind"* (Farrar, Straus) is a marvelous and readable history of debt in the US. Don't miss it.

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I don't care what city you go to, if you're downtown you're going to see homeless men and women pushing shopping baskets full of gad knows what. NYC is reputed to have 30,000 homeless and San Diego 6,000. The candidates are all blathering about "change," but as this cartoon indicates, "change" can mean different things to different people.

Jim Borgman, The Cincinnati Enquirer

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I've been saying this for quite some time, but here are some facts. Of the 102 professional sports teams (football, baseball, hockey, basketball), 23 lost money last year. And the trend does not look good. One reason is that TV money is going to shrink with the upcoming contracts. Part of the problem is also the egos (stupidity?) of the franchise owners in bidding salaries to climb through the roof. Another problem will be ticket-shock, meaning that the public simply will resist the ever-rising cost of attending the games.

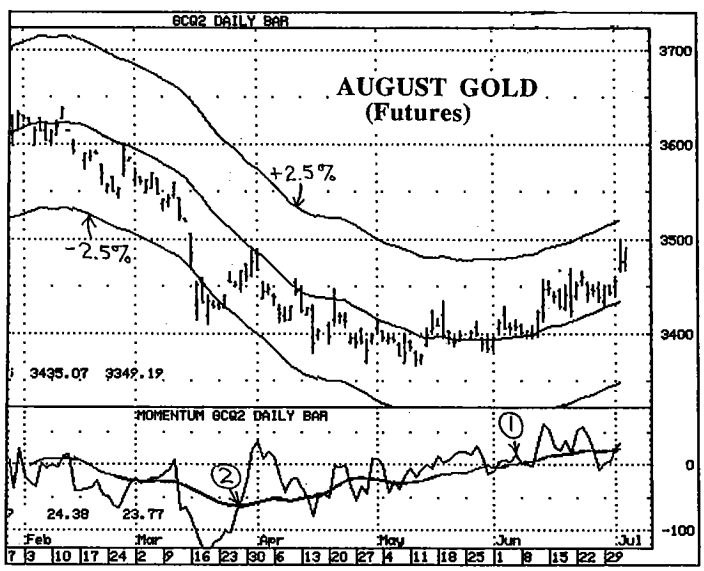
GOLD: The Picture: In its battle against a debt-ridden, deflationary economy, the Fed has been pumping money into the banks in massive amounts. In doing so, the Fed has laid the foundation for future inflation. But it doesn't have to happen that way. In the deflationary economy of the 1930s they gave money away (bill rates were down to 0.25%), but the Great Depression was in force, and nobody wanted to borrow, regardless of the price of money.

Nevertheless, the Fed has made money very cheap in the US, and the bond market knows it and the gold market knows it. But will the Fed's action lead to inflation? Or will the deflationary forces of sky-high debt, high unemployment and widespread bankruptcies overpower inflation? No one has the answer to that one -- at least not yet.

The Fed may be pushing on a string (remember, the money supply doesn't increase unless the banks make loans). From that standpoint, the economic picture is not encouraging. The latest figures from the St. Louis Fed show Commercial and Industrial loans dropping to new lows for the year. Actually, between April 8 and June 17 these loans dropped at the astounding compounded annualized rate of 11.1%. Is it any wonder the country is not out of recession?

GOLD PRICE ACTION: We don't know what gold may be anticipating, but for whatever reason, gold is beginning to act well. Here's a chart showing daily gold action going back to last February. The center line of the three lines is a 21-day moving average of gold. In June, for the first time this year, gold has broken cleanly above its 21-day moving average (MA). The two outside channel lines are drawn 2.5% above and 2.5% below the moving average. If gold has definitely turned bullish, it should tend to hold within the envelope and the channels should continue to rise.

At the bottom of this same chart we see the 10-day rate of change (momentum) in gold plus a moving average of momentum. The moving average turned positive (i.e., rose above zero) in early June (#1 on chart), the first time that momentum has been positive since February. Note, however, that gold momentum hit its low and turned up in late-March (#2), the earliest hint that gold might be turning bullish.



This latest action makes is much easier to analyze gold. The fact is that gold has finally turned bullish. As long as gold holds above its 21-day moving average it will be classified as bullish. And remember, as long as gold holds above its moving average the MA will continue to rise.

The near-term target for gold (August contract) is 350. If August gold can close above 350, it will have bettered its April peak. This will be a bullish technical achievement and put gold in position to attack the 355-360 resistance zone.

LATE NOTES: Divergences all over the place, but the fact is that the PTI has not broken down, and the Dow is still far above its critical Dow Theory level of 3181.35. It may be that there are just too many bears looking for "the Big Decline." If this market is fated to fall apart, it's not going to do it on the bears' time-table. My opinion: I call this a market looking for a direction.

NEXT MAILING: July 22, 1992